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UNCLAS SECTION 01 OF 02 YEREVAN 001651

SIPDIS

SENSITIVE

DEPT FOR EUR/CACEN

E.O. 12958: N/A

TAGS: [ECON](#) [EFIN](#) [AM](#) [RU](#)

SUBJECT: CENTRAL BANK, MINISTRIES SCRAMBLE TO KEEP THE  
DRAM STABLE AGAINST THE DOLLAR

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SUMMARY  
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1. (SBU) As the Central Bank of Armenia's (CBA) Chairman Tigran Sargsyan left for his summer holiday July 19, a sharp and unexpected appreciation of the Armenian Dram (AMD) against the dollar and euro caused uncertainty and suspicion in Armenia's currency markets. With rare volatility, the dram rose 10 percent against the dollar (to AMD 495) in the beginning of the week of July 19, its highest level since 1998, only to fall back by 6 percent later in the week. The press and the banking community blamed the CBA for reacting too slowly, hinting that the market had been manipulated with the tacit acquiescence of the bank. The CBA appeared to intervene only after a political meeting with the President and Ministry of Finance and Economy (MFE), despite the bank's ostensible autonomy. Although it is too early to say what caused the sudden volatility, the bumpy ride exposed the lack of confidence the banking community has in the ability of Armenia's currency markets to resist speculative manipulation, and of the CBA to guarantee the stability of the Dram. End Summary.

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DRAM CHANGES COURSE IN 2004  
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2. (SBU) Since it was introduced in 1993 and until the end of 2003, the Dram continued on a slow depreciation against the dollar of about 3 percent annually. This year, due only in part to the dollar's fall against all currencies, the Dram has steadily climbed from its all-time low (AMD 590/1 USD) in December 2003. By the end of the first quarter it gained value to 560 and reached 540 by the end of the second quarter. In contrast to the dram's steady rise all year, last week's appreciation to AMD 495 USD was widely viewed as too high, triggering banks and businesses to quickly buy dollars aiming to turn a quick profit. The MFE tried to intervene at this point and purchase USD 10 million in dollars, but the CBA prevented the sale and instead intervened by lowering the overnight Dram lending rate by a point.

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THE CENTRAL BANK: "WE HAVE A FREE FLOATING CURRENCY"  
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3. (SBU) In a recent conversation with the Ambassador, the Chairman of the CBA, Tigran Sargsyan, commented that the sharp appreciation of AMD was caused by seasonal factors, such as foreign remittances, increased investment flows and tourism. Sargsyan insisted that the CBA is following the free-float pricing policy for its currency and does not interfere in the foreign exchange market. He predicted that the recent volatility would be stabilized by October, when seasonal effects are weaker.

4. (SBU) Local bankers note that there has no significant increase in the inflow of tourism dollars or remittances that could explain the Dram's rise. The stability of the Dram during last year's inflow of USD 80 million from the Lincy foundation suggests that small increases in foreign trade or remittances are unlikely to be the sole cause of such volatility. The Central Bank and two private bankers noted that there was no significant difference in transfers of dollars from abroad, suggesting that Armenia's economy is sufficiently dollarized that significant amounts of dollars can enter the market without the necessity for international transfers.

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USING DRAM APPRECIATION TO MEET INFLATION TARGETS?  
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5. (SBU) The press and bankers alike have accused the CBA of allowing (or even orchestrating) the appreciation in order to meet their increasingly

unrealistic inflation target of 3 percent. For its part the bank denies managing a controlled currency float, although the bank of course periodically buys and sells the dollars and euros it keeps as reserve currency. In a conversation before the sudden peak, CBA board member Vache Gabrielyan commented that the Central Bank had substantial foreign currency reserves, so he didn't expect that the bank would purchase dollars to offset the rising Dram as it has done in the past.

16. (SBU) Note: Consumer price inflation was 8.6 percent last year, due to a rise in the world price of food commodities, especially wheat. A 3 percent target next year seems unrealistic, as fuel and water tariffs will likely rise. Because Armenia relies heavily on imports for its basic consumables, a rise in the Dram should have downward pressure on inflation. But despite the steady appreciation of the Dram this year, inflation remains high at 4.5 percent because basic foodstuffs are not sold in competitive markets, but rather, by de facto import monopolies which translate lower costs into higher profits. End Note.

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DRAMATIC IRONY  
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17. (SBU) The impetus to intervene to stabilize the Dram appeared to come from outside the CBA, which is charged with maintaining its stability. According to Deputy Minister of Finance David Avetissian, the President convened an urgent meeting July 21 with the CBA Chairman and the Minister of Finance and Economy to discuss the rapid rise of the Dram. Minister of Finance Vardan Khachatryan told the press that he had outlined the danger of a strong Dram to the state budget, which is financed in part in foreign currency by international donor organizations. To counteract the threat, Khachatryan proposed that the Ministry intervene on the currency market to buy USD 10 million in dollars, which the budget could use to service loans to foreign lenders. The CBA objected, claiming (rightly) that such interventions were the exclusive domain of the Central Bank. The CBA then proposed to lower the overnight Dram lending rate, which should have encouraged some banks to switch short-term assets into dollars. Deputy Minister Avetissian said that the Dram depreciated by 6 percent shortly after the meeting, as speculators became confident that the Dram increase would be controlled.

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SPECULATION?  
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17. (SBU) A prominent banker, along with the media, suggested that speculators drove the Dram up under the assumption that currency traders would overreact, allowing the speculators to purchase back dollars at an even lower price. The banker added that one local commercial bank was actively selling dollars when the Dram was very high, raising suspicions that they were somehow trying to manipulate the market. Although Chairman Sargsyan insisted that any speculation in the foreign exchange market would be noticed by the Central Bank, the recent rapid appreciation and fallback of the dram has sparked speculation that someone is manipulating the currency markets to his financial benefit. Minister Khachatryan noted in a press conference that President Kocharian had ordered an investigation of transactions during last week to ascertain the cause of the Dram's fleeting spike.

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COMMENT: FINANCIAL MARKETS STILL VULNERABLE  
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19. (SBU) Recent events highlight the fact that Armenia is a small economy that lacks developed financial markets, and is vulnerable to even medium-scale currency flows. Currency traders don't appear to know what to expect from the monetary authorities at the Central Bank. The fact that it apparently took a political meeting to enforce a monetary solution casts doubt on the Central Bank's nominal autonomy. Whatever the cause of the sharp fluctuation in the currency market, the press and the banking community alike were quick to note their lack of confidence in the CBA's ability to ensure a stable and predictable monetary policy.  
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